# 1998

# Ginnie Mae Annual Report

*Our 30th Anniversary*

The Government National Mortgage Association

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# Our 30th Anniversary

## Ginnie Mae Mission

To support expanded affordable housing in America by providing an efficient government-guaranteed secondary market vehicle linking the capital markets with Federal housing markets.

*"For 30 years, Ginnie Mae has been at the heart of affordable homeownership in America. Not only did Ginnie Mae pioneer the mortgage-backed security — now one of the most widely held and traded in the world — but the more than $1 trillion in securities guaranteed by Ginnie Mae has helped tens of millions of American families become first-time homeowners."*

— Secretary Andrew Cuomo

The Honorable Andrew Cuomo
Secretary
United States Department of Housing and Urban Development
Washington, DC 20410

Dear Mr. Secretary:

On this, our thirtieth anniversary, I am pleased to present to you the audited financial statements of the Government National Mortgage Association (Ginnie Mae) for the fiscal year ended September 30, 1998. Once again, Ginnie Mae has received an unqualified opinion from its independent auditors, KPMG LLP, with no findings of material weaknesses or reportable conditions. Ginnie Mae continues to grow stronger and improve its internal control environment.

During fiscal year 1998, Ginnie Mae reached over $1.4 trillion of original issues of mortgage-backed securities guaranteed since 1970. We are quite proud of our continuing accomplishments and our role in the Department's commitment to supporting affordable homeownership for low- and moderate-income families in America.

Strong financial performance continued in fiscal year 1998. Operating results for fiscal year 1998 exceeded historic performance levels and are quite favorable. At year end, our mortgage-backed securities outstanding totaled $542.2 billion, an $11.6 billion or 2 percent increase from fiscal year 1997. Ginnie Mae's net revenues were a record high $674.7 million in fiscal year 1998, a 12 percent increase over fiscal year 1997's $601.2 million. Ginnie Mae's mortgage-backed securities program guaranteed the issuance of $137.8 billion in mortgage-backed securities last year, thereby providing capital for the purchase or refinancing of approximately 1.5 million homes, including multifamily units. Over its lifetime, Ginnie Mae's mortgage-backed securities have financed homeownership opportunities for 22.7 million American families.

Ginnie Mae continues to develop and improve its efficient and effective operations. Several initiatives were implemented in 1998, bringing new products to the market. The commitment to customer service and the resultant organizational structure enables Ginnie Mae to be more responsive to change, focus more resources on mitigating and managing our business risks, improve service to customers, work closely with our partners, and improve monitoring of contractor performance. As a result of this commitment, Ginnie Mae opened an office in New York City to advance our Capital Markets strategy of keeping in closer contact with our securities customers on Wall Street.

In fiscal year 1998, Ginnie Mae completed a Business Process Reengineering effort focused specifically on the Office of Finance. Subsequent implementation of the recommendations is expected to result in an increased use of technology to enhance the efficiency of the Office and to improve its capability to provide greater financial analysis capacity to Ginnie Mae's management.

Ginnie Mae continues to fulfill its mandate to promote access to mortgage credit throughout the nation by increasing the liquidity of investment capital available to the residential mortgage finance market. Ginnie Mae's Targeted Lending Initiative has proven to be tremendously effective in helping to increase homeownership levels in targeted central city communities. Its objective was to bring an additional $1 billion of investment funding annually to 72 designated targeted lending areas. In fiscal year 1998, $3.9 billion in targeted lending pools were issued.

Continuing to incorporate technology has enhanced Ginnie Mae's efficiencies and capabilities. The World Wide Web has become an essential communications channel for educating and informing our customers and the public. It has enabled Ginnie Mae to improve customer service by providing stakeholders with another channel for obtaining information about Ginnie Mae and its programs. The Ginnie Mae Business Center centralizes and provides a substantial improvement in training capability and capacity for our issuers. The newly implemented Electronic Data Interchange provides a more efficient method of transferring data, and offers substantial promise to realize efficiencies in how Ginnie Mae conducts its business.

The continued success of the Ginnie Mae REMIC and Platinum securities has resulted in increased liquidity of mortgage funds. These securities have played a role in increasing the availability of mortgage funds to low- and moderate-income and first-time homebuyers. Ginnie Mae will continue product innovation, program enhancements, investor education, and competitive pricing to ensure that the increased liquidity and efficiencies gained in the capital markets by the multiclass securities program are maintained.

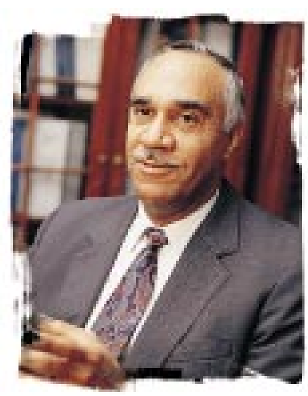
Our business processes and initiatives, organizational structure, and technology improvements are the hallmark of the new Ginnie Mae. Ginnie Mae's commitment and presence in the capital markets provide continuous opportunities for efficiencies, economies of scale, and further refinement of the infrastructure that encourages the achievement of our mission.

We are proud of our continued accomplishments as part of the Department's historic role in helping to make the American dream of homeownership a reality for millions of low- and moderate-income American families.

Sincerely,

George S. Anderson

George S. Anderson
Executive Vice President
Ginnie Mae



30th Anniversary

**1968** Title III of the National Housing Act creates Ginnie Mae
Ray Lappin becomes President of Ginnie Mae

**1970** Ginnie Mae and Fannie Mae initiate the Tandem Plan to purchase non-profit sponsored Section 236 loans (multifamily) and Section 235 homeownership interest subsidy mortgages

## I. Overview of Ginnie Mae

The Government National Mortgage Association (Ginnie Mae) was created in 1968 through amendment of Title III of the National Housing Act. Ginnie Mae, a wholly-owned government corporation within the Department of Housing and Urban Development, was established to support Federal housing initiatives by providing liquidity to the secondary mortgage market and by attracting capital from the Nation's capital markets into the residential mortgage markets. Ginnie Mae's operations are overseen by the Secretary of Housing and Urban Development and the President of Ginnie Mae, both of whom are appointed by the President of the United States and confirmed by the United States Senate.

Ginnie Mae guarantees the timely payment of principal and interest on securities issued by private institutions and backed by pools of Federally-insured or guaranteed mortgage loans. The Ginnie Mae guaranty is *backed by the full faith and credit of the United States.* Each year Ginnie Mae-guaranteed securities provide the financing for approximately 97 percent of all loans insured or guaranteed by the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA).

Ginnie Mae was created in 1968, during a period of rapid change in the mortgage finance industry. From this dynamic environment, Ginnie Mae emerged as a pioneer with the development of the Mortgage-Backed Securities (MBS) program. MBSs issued under this program are a vehicle to efficiently and effectively generate capital that enables lenders to provide a steady supply of mortgage credit.

Over its lifetime, Ginnie Mae's mortgage-backed securities have financed homeownership opportunities for 22.7 million American families, including multifamily units. Today, the mortgage finance industry faces new challenges that demand creative leadership and innovative solutions. Ginnie Mae has repositioned itself to meet new market challenges while playing a pivotal role in achieving the Department's goal of providing low-cost mortgage credit to traditionally underserved sectors of the housing market. Ginnie Mae's mission, goals, and related accomplishments for fiscal year 1998 are detailed in this report.

## II. Corporate Goals

Ginnie Mae's mission and strategic vision have been captured in three overarching goals. These goals guide the organization in the prioritization of its resources and activities to focus on outcomes rather than outputs and processes. The goals to which Ginnie Mae holds itself accountable are stated below.

### Goal 1: Excellence in Customer Service

Ginnie Mae will provide excellent service to its customers. "Customers" shall include program participants (e.g., issuers and investors) and other stakeholders (e.g., homeowners and prospective homeowners, taxpayers, securities holders, the FHA, the VA, and the Rural Housing Service (RHS)).

### Goal 2: Leadership Role in the Industry

Ginnie Mae will play a leadership role in the affordable lending marketplace. Leadership includes taking action to increase affordable homeownership and rental housing nationwide through the introduction of new products and expansion of affordable mortgage credit.

### Goal 3: Integrity and Excellence in Financial Management

Ginnie Mae will manage its financial risk.

## III. Process, Infrastructure and Technology Improvements

As part of our commitment to excellence in customer service, during fiscal year 1998, Ginnie Mae continued to build the infrastructure that will assist in the improvement of services and communication to issuers and other program participants. After completing its first round of "Opportunities for Improvement" in fiscal year 1996, Ginnie Mae continued to improve and streamline its operations in fiscal years 1997 and 1998. The resulting efficiencies are providing substantial savings to the mortgage market. Ginnie Mae streamlined its processes and provided greater flexibility in its guidelines and regulations in order to meet its goals.

In recognition for its performance, Ginnie Mae received the National Performance Review "Hammer" Award in 1998. The award was for innovative and money-saving efforts in support of Vice President Gore's reinventing government initiative. The award pertained to the Business Process Reengineering development conducted by Ginnie Mae.

### Organizational Structure

Beyond the process improvements, Ginnie Mae's organizational structure enables Ginnie Mae to be effective in responding to change, to focus resources on mitigating and managing its business risks, to improve customer service to issuers, and to improve contractor oversight.

*The Office of Customer Service* continues to provide a valuable service for Ginnie Mae customers, and is dedicated to fulfilling its goal of providing a single point of contact with the issuer community. The Account Executives charged with achieving this goal are continually striving to assist our customers while maintaining the integrity of the overall Ginnie Mae mortgage-backed securities program. The Office of Customer Service stays abreast of industry trends to better understand our customers' concerns and suggestions. It also promotes leading edge approaches to doing business in the dynamic secondary mortgage market. To that end, the Office of Customer Service was instrumental in promoting the highly successful Targeted Lending Initiative and participating in industry forums on how to conduct business more effectively and lower the financing costs to low- and moderate-income homebuyers. In addition, Capital Markets customers have direct access to Ginnie Mae's Capital Markets Division, where expertise in mortgage securities markets is available to support the value of Ginnie Mae securities. Ginnie Mae's New York office was established to improve communications between Ginnie Mae and the investment community. The opening of this office is in keeping with our Capital Markets strategy of keeping in closer contact with our securities customers on Wall Street.

Several new products for the Ginnie Mae multiclass securities program were introduced during 1998 including Modifiable and Exchangeable REMIC Certificates, Re-REMICs, Callable Trusts and Callable REMICs. The Office of Customer Service continued to encourage participation in the multiclass program by lowering fees involved in securitizing Platinum and REMIC securities.

*The Office of Multifamily Programs* serves as Ginnie Mae's single point of contact for issuers concerning their participation in Ginnie Mae's multifamily programs. The Office has responsibility from inception through termination in multifamily matters, ranging from approving issuers through disposition of defaulted assets.

*The Office of Program Administration* provides administrative support for the MBS programs. The Office oversees the processing of a variety of actions initiated by Ginnie Mae's customers, manages and directs the activities of several major contractors that provide support in operating Ginnie Mae's programs, and coordinates all Information Technology initiatives for Ginnie Mae through the auspices of Ginnie Mae's Chief Information Officer.

*The Office of Policy, Planning, and Risk Management* evaluates the effectiveness of Ginnie Mae's programs and products, assists in institutional policy formulation and product development, identifies business risks and develops controls and strategies for mitigating them, develops and tracks progress against strategic and annual business plans, and identifies staff development needs and training programs to meet those needs.

*The Office of Finance* maintains management and operational controls for Ginnie Mae, ensures compliance with the reporting requirements of the Federal Financial Managers' Integrity Act and the Chief Financial Officers Act, provides accounting and financial reporting services, manages the investment of Ginnie Mae funds, prepares and monitors the execution of Ginnie Mae's budget, and oversees the management of acquired defaulted assets. The Office of Finance also coordinates the audit of Ginnie Mae, minimizes financial risk, maintains necessary internal controls, and manages and coordinates field audits and reviews of master subservicers and major contractors to minimize risk to Ginnie Mae. The Office of Finance is the liaison between Ginnie Mae and HUD's Inspector General, Office of Management and Budget, General Accounting Office, the U.S. Department of the Treasury, and the U.S. Congress.

## Ginnie Mae Technology and Customer Service

Ginnie Mae is committed to serving the needs of both homebuyers and private sector business partners and offering the best possible customer service to its program participants and issuers. Following are some examples of

the ways in which Ginnie Mae has been using technology and customer service to improve the day-to-day business operations for its issuers.

### *Preparation for the Year 2000*

Ginnie Mae has been actively addressing the Year 2000 issues within its information systems. Ginnie Mae is committed to ensuring that the mission and objectives of the agency will not be disrupted due to Year 2000 induced information technology errors, and that the safety and soundness of Ginnie Mae's mortgage-backed securities programs are protected.

*Readiness*

Ginnie Mae has developed a comprehensive approach to address its Year 2000 readiness. This effort was initiated in 1996 through a preliminary assessment of the date rollover impact on Ginnie Mae's critical business system applications. This assessment strived to gain a full understanding of Ginnie Mae's present Year 2000 situation and the effort required to complete Year 2000 readiness. This effort (1) provided the underlying support to specify to each of Ginnie Mae's business partners the expectations required to remediate Ginnie Mae's systems, and (2) established a Year 2000 program led by its Chief Information Officer with support and input from the Year 2000 executive steering committee. The results of this review led Ginnie Mae to initiate detailed assessments, remediation and testing of each of its key operational business systems, technical infrastructure, personal computers, facilities infrastructure, and contingency planning.

The business of Ginnie Mae is highly dependent on the smooth interaction of numerous internal and external computer systems, and therefore, the Year 2000 issue poses significant operational risk to Ginnie Mae. The three processes that are the highest risk to Ginnie Mae in the event of a Year 2000 failure are: (1) issuance of new pools through GinnieNET; (2) reporting security balances; and (3) payments to investors. All areas of testing and planning revolve around these three processes. Ginnie Mae has actively pursued remediation of its core business systems, and is currently developing contingency plans to reduce the risk of business disruption in the event technology failures do occur. Ginnie Mae recognizes that the industry participants' preparedness to address Year 2000 business processing is critical to Ginnie Mae's ability to satisfy the mission and objectives of supporting the flow of mortgage capital. Therefore, Ginnie Mae requires that each issuer provide a certification that it has taken appropriate action to assure that it will continue to meet all Ginnie Mae requirements. Issuers must also certify that they will establish reasonable contingency plans to ensure that their Ginnie Mae business operations will not be disrupted in the event Year 2000 induced errors do occur. These plans must be finalized no later than July 31, 1999.

Beginning with the first quarter of calendar year 1999, the Mortgage Bankers Association of America (MBA) has been coordinating and facilitating an industry-wide test to ensure that issuers, servicers and other mortgage industry participants will be able to successfully share data and conduct operations in the Year 2000 and beyond. This effort was planned with the participation of Ginnie Mae, Fannie Mae, Freddie Mac, the MBA and major mortgage banking institutions. Planning included defining the scope of the test, identifying criteria for participation, developing test plans, developing test scripts and coordinating with Ginnie Mae business partners to engage within the test.

The approach taken by the MBA was to identify key business transactions throughout the life of a mortgage loan and build corresponding test transactions. The MBA

Mortgage market in turmoil, Ginnie Mae provides only stable source of financing for HUD-insured project mortgages

**1980** 10th Anniversary of the MBS Program, Ginnie Mae guarantees of securities reach $100 billion

requires that all participants complete internal testing. Ginnie Mae strongly encourages its issuers and document custodians to participate in the test. This test requires participants to signup and use the test transactions that have been developed to test key Ginnie Mae transactions (e.g. pool submission, RPB reporting, and loan level reporting). This test provides additional comfort and assurance of our collective ability to operate successfully into the Year 2000.

As part of the MBA's Year 2000 test, Ginnie Mae's participation primarily revolves around the testing of three transactions that pose the highest risk to Ginnie Mae in the event of a Year 2000 failure:

- issuance of new pools through GinnieNET;
- reporting security balances; and
- payments to investors.

To ensure that all systems are ready, Ginnie Mae plans to conduct an end-to-end test on these three transactions. Ginnie Mae issuers testing these transactions (or where appropriate their service bureaus) will be expected to have completed Year 2000 remediation and testing of their own computer based systems. They must also have the ability to simulate future dates and have a test database that they can use for this test. The Year 2000 integrated testing is among a number of activities Ginnie Mae is performing to ensure its Year 2000 preparedness. Ginnie Mae's approach requires close integration of its business partners. The results of the testing will be used not only to assist Ginnie Mae but also provide valuable feedback to the industry to assist issuers and other business partners with their ongoing Year 2000 program initiatives.

Ginnie Mae has developed a comprehensive approach to the Year 2000 issue that includes preventative efforts and contingency planning to address the risks. Ginnie Mae has divided its Year 2000 efforts into four areas of concentration as summarized below:

*Remediation Activities:* Ginnie Mae Year 2000 remediation activities consist of all necessary information systems code changes and testing for Year 2000 date compliance. An independent assessment was performed to ensure that Ginnie Mae's contractors' Year 2000 remediation testing followed industry standards.

*Contingency Planning:* Design and organization of the tests, implementation, activation and eventual deactivation of the contingency plan.

*Issuer Risk Monitoring:* Developing, organizing, and implementing a procedure for tracking and reporting issuer readiness and possible Year 2000 related defaults.

*Y2K Program Closeout*: Activities necessary to closeout Ginnie Mae's Year 2000 program by the end of June 2000.

Ginnie Mae has completed the assessment and renovation stages of the Year 2000 readiness. Currently, Ginnie Mae is proceeding on a dual track of testing and contingency planning.

*Worst Case Scenario*

Ginnie Mae defines the worst case Year 2000 scenario as that circumstance which will affect Ginnie Mae's ability to fulfill its mission. The most likely worst case scenario would occur where 50 percent of the top 50 issuer/servicers are unable to make their pass-through of principal and interest payments to Ginnie Mae. The causes of this scenario could include: internal system problems, telecommunication difficulties or regional power outages causing various segments of the financial community to have interruptions in their operations. Given this circumstance, Ginnie Mae would be required to utilize its reserve balances in order to make payments to security holders. The current reserve level is approximately $6 billion.

In the event these reserve balances become depleted, Ginnie Mae would have to draw upon its unlimited borrowing authority with the U.S. Department of Treasury in order to make security holder payments. Determination of the correct payment to security holders would be calculated based on the previous month's security balance reduced by the pool's principal and interest constant; qualified estimates can be made to calculate unscheduled payments. Further, Ginnie Mae has initiated discussions with Treasury to determine the logistics necessary to provide the funds required to meet Ginnie Mae's obligation. These funds would be wired to Chase Manhattan Bank who would in turn write the checks to be disbursed to the security holders of record.

*Contingency Plan*

A contingency plan was provided to the Department of Housing and Urban Development (HUD) by the General Accounting Office (GAO) in September 1998. In conjunction, Ginnie Mae has developed a Business Continuity Contingency Plan in order to address the likelihood of internal or strategic business partner systems failing. This enterprise-wide plan has been incorporated into the HUD plan. The plan encompasses the full operation of Ginnie Mae including major business partners' business functions and the interaction between business partners and headquarters staff. Pivotal to developing this plan was the need to identify the mission critical business functions of Ginnie Mae. The identification of these business functions has been used to focus testing and resource planning throughout the preparedness process. Ginnie Mae's senior management team will play an integral role in the management of the contingency operations through the Crisis Management team. The Crisis Management team will assess all operations to ensure resources are adequately deployed to meet operational needs.

Ginnie Mae's enterprise-wide plan is an evolving document and is being evaluated to further define processes and scenarios. The plan will be developed through the 2nd quarter of 1999. At that time Ginnie Mae plans to (1) train its operational staff, (2) test the plan with active participation with its business partners, and (3) modify the plan as necessary based on the testing results. In support of the contingency plan execution, Ginnie Mae will develop a command control center that will act as the central point of information flow and support for decision making during contingency mode operations.

*Costs*

Ginnie Mae's Year 2000 project is proceeding as scheduled and budgeted. The estimated total cost to Ginnie Mae is expected to be approximately $4.8 million for the project, which began during 1996 and will run through the year 2000. Approximately $0.6 million has been spent on the project from its inception through September 30, 1998.

*GinnieNET 2020*

GinnieNET 2020 is Ginnie Mae's primary network for conducting business with our customers. GinnieNET enables issuers and their document custodians to submit the majority of pools to Ginnie Mae in a paperless environment. GinnieNET has decreased the processing time from 5 or 10 days to as little as two business days depending on the pool type. The implementation of electronic signature technology through GinnieNET has provided the following benefits to our issuers:

- lower warehouse costs;
- lower mailing costs; and
- reduced paper handling.

As a result of work accomplished in fiscal year 1998, issuers on GinnieNET have been able to submit additional pool types in a paperless environment. This step has further eliminated paper forms that have been required since the inception of the Ginnie Mae program.

The latest release of GinnieNET 2020, Version 5.1, includes the following system enhancements:

- ability to electronically submit Ginnie Mae II multiple issuer pools;
- ability to electronically submit pools having multiple escrow accounts;
- ability to electronically submit Serial Note and Builder Bond Pools;
- comprehensive fax to issuers and custodians of more detailed information (for example, certified or rejected pool numbers);
- ability to electronically submit pools that are transferred to another issuer immediately after the pools are issued;
- made improvements to GinnieNET to accommodate Native American loans (Section 184) in Ginnie Mae's single family pools. This initiative enables Ginnie Mae to provide a secondary market for Native American loans;

- expanded the time frame for pooling single family loans from 24 months to 48 months after origination. This enables lenders to pool older loans into Ginnie Mae securities; and
- enhanced GinnieNET to accommodate serial note pools in book entry form. This has enabled Ginnie Mae to reduce serial note pooling time from 10 business days to 2 business days, which results in substantial savings in the form of lower warehousing cost for Puerto Rican issuers. Ginnie Mae worked with the Puerto Rican issuer community to make improvements to Ginnie Mae's book entry system to accommodate serial note pools in an efficient and cost-effective manner.

Planned enhancements for the next release will address issuer requests by providing the following additional business process improvements:

- ability to electronically submit final certification of pools with an issue date of May 1, 1998 and later, and recertifications at the pool level (as specified in the Ginnie Mae Guide); and
- ability to electronically submit pool accounting, servicing, and payment information (HUD Forms 11708, 11710D, and 11714).

GinnieNET 2020 is evidence of Ginnie Mae's continuing commitment to providing state of the art technology for all of its users. Ginnie Mae is building on existing technology to provide efficiencies to its own business processes as well as those of its customers.

During 1998 Ginnie Mae also:

- implemented electronic payments capability for all Ginnie Mae II single family pools issued in book entry form, prospectively, effective with November1, 1998 issuances. This initiative required working closely with the Mortgage Bankers Association, Bond Market, and The Depository Trust Company; and
- performed extensive work to implement a Ginnie Mae initiative to eliminate the physical certificate on new issues of Ginnie Mae single family pools. This initiative will enable Ginnie Mae to further reduce pool processing time by an additional work day.

*Below are examples of other systems that are available to facilitate business with our customers and improvements made to those systems.*

### *Ginnie Mae Web Site*

The Ginnie Mae web site provides issuers, homebuyers, mortgage finance industry participants, securities investors, and all other interested parties with general information about the Ginnie Mae Mortgage-Backed Securities Program. The site also provides online access to the Ginnie Mae Program Guides I and II, as well as All Participant Memos issued by Ginnie Mae within 24 hours of their release. In fiscal year 1998, a search engine was added to the site to allow key word searches. The Ginnie Mae Web site serves as a quick and efficient communications tool to keep program participants informed about the latest industry news and developments. Ginnie Mae is also exploring other Web applications and plans to do much more via the Web. The Web site address is:

http://www.ginniemae.gov

## *Multifamily Database*

Ginnie Mae's multifamily database, introduced in the summer of 1997, places multifamily pool information at dealers' fingertips. The database is accessed from Ginnie Mae's web site, and is another example of Ginnie Mae's commitment to providing the highest level of customer service to its constituents.

The multifamily database has approximately 3,000 records of Project Loan (PL), Project Note (PN), Mature Loan (ML), and Small Loan (SL) pools. Investors, traders, and issuers can rely on this database for up-to-date information on multifamily pools. From Ginnie Mae's web site, investors can search the database by Pool Number, CUSIP Number, FHA Case Number, Pool Type, or Issuer Number, and retrieve detailed information to help with investment decisions. Pool level information includes: Issuer Name, Project City and State, Maturity Date, and Interest Rate. Loan level information includes: Mortgage Loan Origination Date, Lockout Term and Lockout Period Ending Date, Prepayment Term, and Prepayment Period.

## *"Your Path to Homeownership" Software*

Your Path to Homeownership is a mortgage pre-qualification software package designed to increase awareness of homeownership possibilities for people in Targeted Lending areas. This software package will be accessible from Ginnie Mae's Web Site in early spring 1999. HUD Community Builders will have access to this software as they consult with potential homeowners in Targeted Lending areas about homeownership opportunities.

## *The Issuer Information System and Bulletin Board System*

The Issuer Information System allows issuers that do not use service bureaus for data processing to enter, store, and update Ginnie Mae monthly and quarterly investor reporting information. Upgrades of the software are released periodically to provide added functionality and improved software performance. The Ginnie Mae Bulletin Board System allows issuers to submit the investor reporting information to Ginnie Mae electronically. The system provides issuers with a very efficient way of transmitting data, and allows Ginnie Mae to provide timely feedback.

## *The Electronic Data Interchange (EDI) Program*

The successful implementation of EDI by issuers has further facilitated Ginnie Mae's commitment to providing more efficiency and effectiveness in the quarterly inventory reporting process. Issuers that have implemented EDI are now able to use the same transaction set for investor reporting with Ginnie Mae, Freddie Mac, and Fannie Mae. Apart from the reduced use of paper and other physical media processing methods, issuers receive quicker feedback on the success of submissions, and feedback about problems with reported data before the next quarterly cycle. In response to issuer requests, Ginnie Mae added the Frame Relay telecommunication method for Ginnie Mae's medium and large loan volume issuers. Frame Relay can be more cost-effective than ISDN for larger data submissions. For the smaller loan volume issuers, Ginnie Mae is designing a Web-based EDI solution that will be available in fiscal year 1999.

**1987** The automated Commitment Line System (CLS) is initiated to improve efficiency and reduce paperwork for Ginnie Mae and the issuer community

**1986** Ginnie Mae securities issued since inception surpass $300 billion

### *Ginnie Mae's Commitment to Customer Service*

Ginnie Mae account executives are available by phone to help our customers with a variety of issues:

- Mortgage-Backed Securities (MBS) Issuer Contact: (202) 708-1535
- Multifamily MBS Issuer Contact: (202) 708-2043
- Single Family MBS Issuer Contact: (202) 708-1535
- Ginnie Mae Capital Markets Contact: (202) 401-8970
- GinnieNET Customer Service Contact: 1 (800) 234-GNMA
- Ginnie Mae Hotline: 1 (888) Ginnie4

The Ginnie Mae Hotline supports helpdesks for the following programs: Electronic Data Interchange; the Issuer Information System and Bulletin Board System; the Web Site; the Soldiers' and Sailors' Civil Relief Act; Issuer Verification Forms; Remaining Principal Balance; and Year 2000 issues.

## IV. Ginnie Mae Initiatives

In response to the rapidly changing market in mortgage finance, Ginnie Mae has increased its efforts to bring new products to the marketplace.

### Multiclass Products

In 1998, Ginnie Mae guaranteed a record $36.9 billion in multiclass securities. Multiclass products were introduced to make Ginnie Mae securities more attractive to investors. The Ginnie Mae Multiclass securities program consists of Real Estate Mortgage Investment Conduit (REMIC) Securities, Ginnie Mae Platinum Securities and Callable Trusts, which use Ginnie Mae I and II mortgage-backed securities as collateral.

*Ginnie Mae Re-REMICs*: The new Ginnie Mae Re-REMIC is backed by Ginnie Mae, Fannie Mae and/or Freddie Mac REMICs, provided that the REMIC is ultimately backed by Ginnie Mae MBS. These securities create a unique opportunity for investors to combine REMICs from three different guarantors. The flexibility of Ginnie Mae's multiclass products contributed to Ginnie Mae's best year ever as measured by multiclass volume. In 1998, Ginnie Mae guaranteed $6.6 billion in REMICs which used the Re-REMIC option.

*Modifiable and Exchangeable REMIC Certificates:* Modifiable and Exchangeable (MX) REMIC certificates are included in the structure of Ginnie Mae REMICs. This structuring flexibility gives REMIC investors the ability to exchange specified REMIC classes for proportionate interests in MX classes that meet their investment requirements.

*Callable Trusts and Callable REMICs:* Callable Trusts consist of pairs of classes, designated A and B. The A class may be redeemed at the option of the investor in the B class. These securities allow investors to better manage prepayment risk by providing lockout periods and call redemptions at known prices. Callable Trusts may be used to back a REMIC to further customize the securities as demanded by investors. Ginnie Mae guaranteed $2 billion in Callable Trusts in 1998.

*Ginnie Mae Platinum:* Ginnie Mae has experienced continued success with its Platinum program. Since the inception of the Ginnie Mae Platinum Security program in November 1994, approximately 200,000 MBS pools have been consolidated into 858 Ginnie Mae Platinum pools totaling more than $71.6 billion in securities. During 1998, Ginnie Mae made it possible for investors to submit Ginnie Mae Platinum securities in the formation of new Ginnie Mae Platinum securities. In addition, fee adjustments were made to encourage the formation of Ginnie Mae Platinum pools that exceed $1 billion in size.

Under changing economic and market conditions, this range of products allows Ginnie Mae to better satisfy investor needs and thus ensure continuous availability of capital to the mortgage markets.

In September 1998, Ginnie Mae sponsored the first investor symposium at the Ginnie Mae Capital Markets Office in New York. It was an excellent opportunity to inform investors about Ginnie Mae and FHA initiatives, as well as receive input from investors in Ginnie Mae securities.

## Ginnie Mae Targeted Lending Initiative

In fiscal year 1998, Ginnie Mae continued the Targeted Lending Initiative, which was initiated in fiscal year 1997 to help raise homeownership levels in central city areas. The Targeted Lending Initiative provides financial incentives for lenders to increase loan volumes in traditionally underserved areas. By increasing lender activity in these targeted areas, Ginnie Mae provides families and households with additional opportunities to achieve homeownership.

During fiscal year 1997, Ginnie Mae issued $1.3 billion Targeted Lending pools. In fiscal year 1998, more than $3.9 billion in Targeted Lending pools were issued.

Under the Targeted Lending Initiative, Ginnie Mae reduced its guaranty fee by up to 50 percent when approved issuers originate (or purchase) home mortgage loans in one of 72 designated urban communities around the nation and place them in Ginnie Mae pools. The Ginnie Mae guaranty fee may be reduced by 1 to 3 basis points on a pool, depending on the percentage of unpaid principal balance of eligible FHA-insured and VA-guaranteed loans in the pool.

Seventy-two eligible communities in 69 Metropolitan Statistical Area (MSAs) have been designated by HUD as Urban Empowerment Zones, Supplemental Empowerment Zones, Enterprise Communities, or Enhanced Enterprise Communities. Underserved areas in these 69 MSAs are also eligible for the new product.

All Ginnie Mae issuers are encouraged to participate in the Targeted Lending Initiative. There is no separate application procedure or pre-approval required. Once a Ginnie Mae issuer has originated or purchased eligible loans, the issuer merely has to indicate the reduced applicable guaranty fee with the pool submission in order to participate in the Targeted Lending Initiative. The Initiative has been effective for pools issued on or after October 1, 1997.

## Ginnie Mae Targeted Lending Initiative: "Your Path to Homeownership" Mortgage Pre-qualification Software

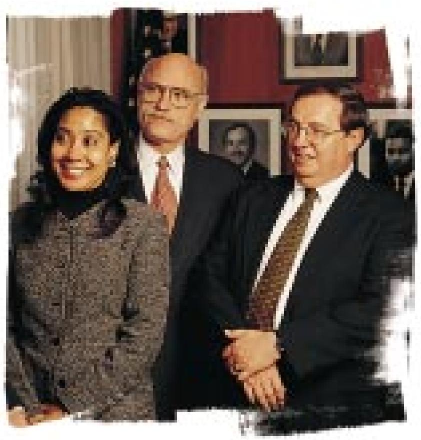
To further increase lending in central cities, Ginnie Mae has developed an easy-to-use mortgage pre-qualification software program (Your Path to Homeownership) for prospective homeowners. The software application enhances consumer awareness of potential homeownership financing opportunities. The program is designed to serve as an educational tool and a pathfinder to community-based information resources or local counseling agencies. Potential borrowers with basic computer skills can operate the computer program with readily available household financial information. Based on the household income and debt information provided, the software will calculate the potential borrower's eligibility for mortgage loans under FHA, VA, or selected conventional loan program guidelines.

## Multifamily Customer Satisfaction Survey

During FY 1998, Ginnie Mae conducted the first customer satisfaction survey of multifamily issuers. The comprehensive survey was sent to the Ginnie Mae-approved multifamily community of 136 issuers. With an overall response rate of 71 percent from issuers in 25 States, Ginnie Mae received an abundance of information for program management decision-making.

The results of the survey indicated that respondents had a high level of satisfaction with the overall knowledge level of the multifamily Account Executives and with the quality of service and timeliness of Account Executives' response to issuer-phone calls. Survey respondents believed improvements could be made in the range of instructional seminars and programs offered to issuers by Ginnie Mae and the helpfulness of Ginnie Mae's voice mail system.

Ginnie Mae will use the feedback from the multifamily issuer community to formulate new initiatives and refine areas needing improvement identified by survey participants.



## Ginnie Mae Audits and Internal Controls

The Ginnie Mae Office of Finance managed and coordinated audits and reviews of its contractors. During fiscal year 1998, Ginnie Mae's auditors conducted 13 contract compliance audits and internal control reviews of its major contractors.

These audits were conducted to determine if the contractors complied with the terms of their contracts with Ginnie Mae. During these audits, verification was made that the bills were accurate and internal controls were reviewed to ensure that the contractors' current operating environment minimizes risk to Ginnie Mae. Ginnie Mae

**Annual Defaulted Portfolios by Program Type**
(dollars in millions)

| | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| Single Family | $8.3 | $350.6 | $60.6 | $201.8 | $85.7 |
| Multifamily | 0.0 | 0.0 | 0.0 | 236.6 | 31.7 |
| Manufactured Housing | 0.3 | 0.0 | 0.0 | 2.0 | 0.0 |
| Total | $8.6 | $350.6 | $60.6 | $440.4 | $117.4 |

regularly monitors contractors with identified weaknesses to ensure that the weaknesses are resolved.

These periodic audits and reviews help to protect, safeguard, and improve Ginnie Mae's MBS program. The audits and reviews:

- enhanced Ginnie Mae's ability to monitor its contractors' financial operations;
- managed risk to Ginnie Mae and protected its assets;
- strengthened Ginnie Mae and its contractors' internal controls; and
- strengthened and contributed to Ginnie Mae's financial management performance.

## V. Program Activities

Ginnie Mae issued $130 billion in commitment authority in fiscal year 1998, a 31 percent increase over fiscal year 1997. Ginnie Mae guaranteed $137.8 billion of MBSs during fiscal 1998, representing an increase of 41 percent from the prior year. Lower interest rates and a strong housing market in fiscal year 1998 contributed to the continuing strong financial performance.

Of the $137.8 billion of MBSs guaranteed, over $133.8 billion was backed by single family mortgages, $3.7 billion by multifamily construction and project loans, and $0.3 million by manufactured housing loans. One of Ginnie Mae's goals for performance measures is to maintain a 95 percent securitization rate of FHA and VA loans. In fiscal year 1998, Ginnie Mae securitized 96.7 percent of FHA and VA loans.

Delinquency ratios for the MBS pooled mortgages declined in the single family, multifamily, and manufactured housing programs when compared to the previous fiscal year. Ginnie Mae will continue to monitor issuers through the Issuer Portfolio Analysis Database System for unusual fluctuations in portfolio delinquency rates. From fiscal year 1997 to fiscal year 1998, the three-month delinquency rate in the single family program decreased from 1.97 percent to 1.64 percent, demonstrating a level consistent with delinquency ratios in past fiscal years. The three-month delinquency rate in the manufactured

**1994** Ginnie Mae securities issued since inception surpasses $1 trillion on July 1, 1994

housing program decreased from 4.64 percent to 3.52 percent. The two-month delinquency rate in the multifamily program decreased from 0.92 percent to 0.78 percent.

## Single Family and Manufactured Housing Programs

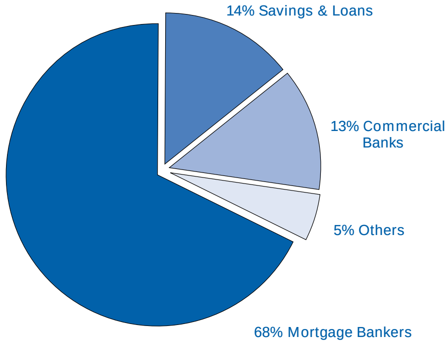
During fiscal year 1998, Ginnie Mae acquired one single family portfolio with an aggregate principal balance of $8.3 million representing a $342.3 million decrease from the $350.6 million acquired in fiscal year 1997. Ginnie Mae also acquired one manufactured housing portfolio with an aggregate principal balance of $328,000 in fiscal year 1998.

By the end of fiscal year 1998, Ginnie Mae had an acquired servicing portfolio of $627 million, a decrease of 24 percent from fiscal year 1997. This $199.9 million decrease was due mostly to pay-off activity and normal amortization of principal, slightly offset by the two acquired issuer defaults. The single family acquired portfolio decreased by 21 percent to $478 million as of September 30, 1998. Overall, the single family acquired portfolio represents 0.09 percent of the total single family remaining principal balance outstanding for the Ginnie Mae MBS program and a decrease of 0.12 percent from fiscal year 1997.

The manufactured housing acquired portfolio experienced a 32 percent decrease during the year to $149 million at September 30, 1998. The decrease was primarily a result of normal program operations and other liquidations. Overall, the manufactured housing acquired portfolio represents 14 percent of the total manufactured housing RPB outstanding, a decrease of 16 percent from fiscal year 1997.

## Multifamily Mortgage-Backed Security Programs

Since the inception of the Multifamily MBS Program, Ginnie Mae has guaranteed the issuance of approximately $33.7 billion in multifamily securities.

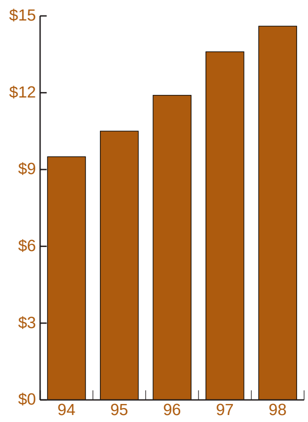



**MBS Program Participants**

Ginnie Mae's Multifamily MBS Programs experienced a banner year in fiscal year 1998. Issuances of new securities were up, delinquencies were down and there were no issuer defaults.

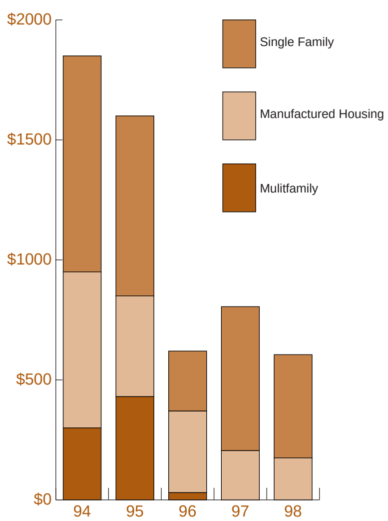
Outstanding securities in the Multifamily Programs increased again by over 7 percent to a record $14.6 billion. This was a result of the issuance of $3.7 billion in securities during fiscal year 1998. Commitments issued for Multifamily Securities also increased from the previous year by 17 percent to $3.5 billion.

The ratio of delinquent multifamily loans in Ginnie Mae multifamily pools decreased to 0.78 percent from 0.92 percent the previous year, a 15 percent decline. Also, for the fourth consecutive year Ginnie Mae experienced no multifamily issuer defaults.




**Multifamily MBS Outstanding**

(dollars in billions)




**Management of Defaulted Portfolio**

(dollars in millions)

With increased promotion of the Multifamily Programs of Ginnie Mae, the percentage of FHA multifamily loans securitized in Ginnie Mae MBS increased from 54 percent in fiscal year 1996 to 81 percent in fiscal year 1997 and 1998. This is up from just 20 percent a mere five years ago. The number of issuers participating in the Multifamily Programs increased by 10 percent during fiscal year 1998.

Finally, Ginnie Mae reduced the Multifamily Pool processing time for the issuance of new pools from five business days to three business days during the fiscal year. This is the second decrease in a 12-month period. This was accomplished by streamlining the process and eliminating pooling documents that did not add value to the review process.

## Ginnie Mae Multiclass Program

During 1998, Ginnie Mae built on its successful multiclass securities program to continue its initiatives that support the value of the Ginnie Mae MBS. As part of Ginnie Mae's Office of Customer Service, the Capital Markets Division gives Ginnie Mae customers direct access to expertise in the mortgage securities markets and disclosure data necessary for Ginnie Mae investors.

During fiscal year 1998, Ginnie Mae guaranteed $17.6 billion in REMIC securities resulting in $4 million in fees to Ginnie Mae. Ginnie Mae also guaranteed $19.3 billion in Ginnie Mae Platinum securities, generating $14.5 million in fees, a portion of which are reserved for future expenses.

Ginnie Mae's REMIC securities give investors the ability to customize MBS securities to their individual requirements. Ginnie Mae Platinum Securities permit the combination of smaller, less liquid MBS pools into fewer, larger Ginnie Mae MBSs. The conversion reduces the administrative costs of holding MBS. Multiclass securities improve the pricing of Ginnie Mae MBS, which in turn reduces interest rates for low- and moderate-income homeowners.

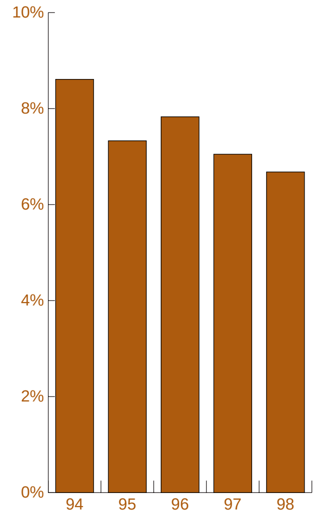
The continued success of the Ginnie Mae REMIC and Platinum programs has resulted in increased liquidity of mortgage funds. Although many economic factors are involved in the change in the supply of mortgage funds, the Ginnie Mae REMIC and Platinum securities have played a role in increasing the availability of mortgage funds to low- and moderate-income and first-time homebuyers. Ginnie Mae will continue product innovation, program enhancements, investor education, and competitive pricing to ensure that the increased liquidity and efficiencies gained in the capital markets by the multiclass securities program are maintained. The actions are ongoing and provide for the continued accrual of the benefit from the multiclass securities program to mortgagors.

## VI. View of the Future

During fiscal year 1999, Ginnie Mae will continue to facilitate increased homeownership levels in urban areas through such programs as its successful Targeted Lending Initiative.

Ginnie Mae continues to implement policies and procedures that improve program efficiency and customer service. Through new product offerings and reduction in guaranty fees, Ginnie Mae continually strives to make its programs attractive to investors in the capital markets. Additionally, Ginnie Mae continues to make organizational improvements in its business by internal and external review of its operations and by operating as a customer service driven organization. These efforts will continue to strengthen Ginnie Mae's financial position and ensure its ability to meet its mission.

The incorporation of technology, improvements in service to our clients, and other process and product improvements will remain a management priority into fiscal year 1999 as well as into the 21st Century. Ginnie Mae will endeavor to face the challenges of the future with confidence and innovative solutions and products, while striving to serve its vital historic role in the provision of mortgage credit for low- and moderate-income American families.

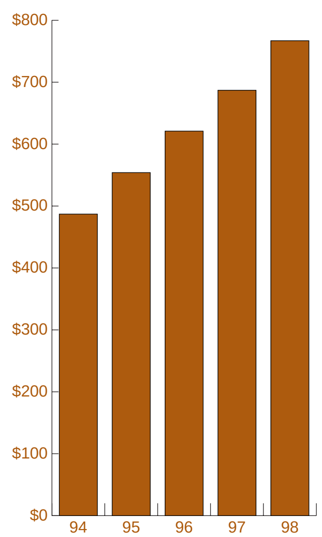


Rates on Ginnie Mae MBS

# VII. Management's Discussion and Analysis of Financial Position and Results of Operations

## Financial Highlights of 1998

Fiscal year 1998 was another year of very favorable financial achievement marked by increases in both revenues and assets. Ginnie Mae's financial management team reported record net income of $674.7 million, a 12 percent increase from $601.2 million in fiscal year 1997. Revenues increased by 12 percent, to $767.4 million from $686.7 million in 1997, and total assets increased 12 percent, to $6.4 billion from $5.7 billion in 1997. These record growth rates are indicative of strengthened financial management and the continued growth in Ginnie Mae's MBS programs during fiscal year 1998.




**Revenue Growth**

(dollars in millions)

The combination of favorable mortgage market conditions and strong program management resulted in an increase in the outstanding MBS portfolio, which generated increased guaranty and commitment fee revenue. In fiscal year 1998, MBS program income rose to $392.3 million from $353.8 million in fiscal year 1997. Total expenses as a percentage of total revenues increased slightly from 5.6 percent in fiscal year 1997 to 5.9 percent in fiscal year 1998.

Commitment authority was issued in the amount of $130 billion, a more than 31 percent increase from the prior year. The $137.8 billion of MBS issued in fiscal year 1998 resulted in a more than 41 percent increase in MBSs issued over the prior year. The outstanding MBS balance at the end of fiscal year 1998 was $542.2 billion, a 2.2 percent increase over the previous year. Fiscal year 1998 production provided the capital to finance the purchase or refinance of homes for approximately 1.5 million American families.

Ginnie Mae has continued its strong financial performance during fiscal year 1998 and produced additional growth in its revenues. Excess revenues over expenses are invested in U.S. Government securities and provide the capital base to support Ginnie Mae's mission. To date, Ginnie Mae's earnings and fund balance have provided the capital to finance its operations and, as a result, Ginnie Mae has not needed to obtain funds through Federal appropriations.

# Three-Year Financial Highlights

| September 30, | 1998 | 1997 | 1996 |
|---|---|---|---|
| Dollars in thousands | | | |
| **Balance Sheet & Liquidity Analysis** | | | |
| Funds with U.S. Treasury | $778,700 | $155,800 | $131,200 |
| U.S. Government Securities | $5,448,300 | $5,382,000 | $4,785,100 |
| Total Assets | $6,366,400 | $5,682,900 | $5,042,400 |
| Investment of U.S. Government | $5,809,300 | $5,134,600 | $4,533,400 |
| Total Liabilities | $557,100 | $548,300 | $509,000 |
| Total RPB Outstanding (1) | $542,206,575 | $530,553,333 | $497,887,840 |
| LLR (2) & Investment of U.S. Government | $6,320,500 | $5,642,300 | $5,005,100 |
| Investment of U.S. Government as a percentage of Average Total Assets | 96.43% | 95.75% | 94.73% |
| LLR & Investment of U.S. Government as a percentage of RPB | 1.17% | 1.06% | 1.01% |
| Capital Adequacy Ratio (3) | 1.15% | 1.05% | 1.00% |
| **Statement of Revenues and Expenses & Profitability Analysis** | | | |
| Revenues | $767,400 | $686,700 | $621,000 |
| Excess of Revenue Over Expenses | $674,700 | $601,200 | $515,500 |
| MBS Program Income | $392,300 | $353,800 | $335,200 |
| Interest Income | $362,700 | $318,200 | $274,100 |
| Total Expenses | $45,600 | $38,700 | $36,200 |
| MBS Program Expenses | $36,300 | $29,400 | $27,100 |
| Administrative and Other Expenses | $9,300 | $9,300 | $9,100 |
| Total Expense as a percentage of Average RPB | 0.0085% | 0.0075% | 0.0075% |
| Provision for Loss as a percentage of Average RPB | 0.009% | 0.009% | 0.014% |

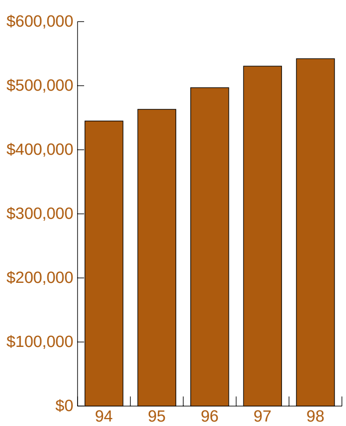
(1) Remaining Principal Balance (RPB) of Ginnie Mae MBSs
(2) Loan Loss Reserve (LLR) established to account for probable future losses
(3) Investment of U.S. Government plus Loan Loss Reserve divided by the sum of Total Assets and Remaining Principal Balance

## Results Of Operations

### *MBS Program Income*

MBS program income includes Guaranty Fees, New Issuer Fees, Commitment Fees, Handling Fees, and Transfer of Servicing Fees. Guaranty Fees and Commitment Fees comprise 95 percent of the total MBS program revenues. Guaranty Fees represent income streams earned for providing Ginnie Mae's guaranty of "the full faith and credit of the U.S. Government" to MBS issues. These income streams are recognized over the life of the outstanding mortgage-backed securities. Commitment Fees represent income Ginnie Mae earns for providing approved issuers with authority to pool mortgages into Ginnie Mae mortgage-backed securities.

Commitment Fees increased 53 percent from $19.6 million in 1997 to $29.9 million in 1998. This increase was a direct result of an increase in issuer demand for new commitments. New commitments issued by Ginnie Mae amounted to $130.0 billion during fiscal year 1998, a more than 31 percent increase from fiscal year 1997.




**Remaining Principal Balance Outstanding of the MBS Portfolio**

(dollars in millions)

Steady growth in the MBS portfolio drives the increase in MBS program income. MBS Guaranty Fees increased 4.6 percent, to $341.5 million from $326.4 million in 1997. The Guaranty Fees are collected on the aggregate principal balance of the guaranteed securities outstanding of the non-defaulted issuer portfolio.

### *Interest Income*

Ginnie Mae funds its investment portfolio through its excess revenues over expenses. As a result, the corresponding interest income has steadily increased over the past five years. For fiscal year 1998, interest income increased 14 percent to $362.7 million from $318.2 million in 1997. This increase is directly related to Ginnie Mae's investment strategy, and its corresponding increasing investment portfolio. Ginnie Mae uses sound portfolio management in investing the excess of its revenues over expenses only in U.S. Government securities.

### *Multiclass Revenues*

Multiclass revenue is part of the MBS program revenue, and it is composed primarily of REMIC and Platinum Program fees and miscellaneous income earned from the Ginnie Mae II portfolio. The multiclass income amount fluctuates based on market conditions. Ginnie Mae issued over $19.3 billion in Platinum securities in fiscal year 1998. Fees amounted to $14.5 million, an increase of 16 percent over the preceding year. Fees from REMIC and Callable Trusts securities amounted to $4 million on over

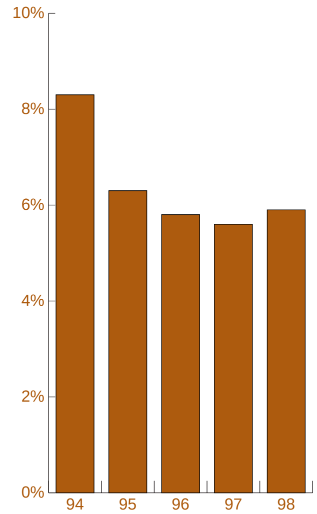
$17.6 billion in issuance for those products. Ginnie Mae recognizes REMIC and Callable Trust income as its earned. A portion of the Platinum Program fees is recognized in the year received and the balance is deferred.

Additional information on REMIC activity is presented under the section entitled "Ginnie Mae Multiclass Program."

### *MBS Program and Administrative Expenses*

MBS Program and Administrative Expenses are incurred to carry out Ginnie Mae's programs and initiatives. These costs include contractor services, personnel, compensation, printing and other administrative functions. MBS Program and Administrative Expenses increased $6.9 million during fiscal year 1998 to $45.6 million from $38.7 million in fiscal year 1997.

The modest increases in expenses is attributable to the cost of launching new products and the significant increase in program activities. Revenues and MBSs outstanding grew at a rate of 12 percent and 2 percent, respectively. Total expenses as a ratio of total revenues increased only slightly from 5.6 percent in fiscal year 1997 to 5.9 percent in fiscal year 1998. However, total expenses as a percentage of total revenues declined over the last five years from 8.3 percent to 5.9 percent. Additionally, MBS Program and Administrative Expenses as a percentage of average remaining principal balance (RPB) declined over the last five years from 0.0094 percent to 0.0085 percent. This favorable trend reflects Ginnie Mae's commitment to the prudent stewardship of its assets.




**Expenses as a Percentage of Gross Revenues**

### *Credit-Related Expenses*

Credit-related expenses include Ginnie Mae's provision for loss and defaulted issuer portfolio costs. The provision for loss is charged against income in an amount considered appropriate to maintain reserves for losses at levels management determines adequate to absorb potential losses from defaulted issuer portfolios and program losses. The provision for loss increased slightly in 1998 to $47.1 million from $46.8 million in the prior year to provide for potential losses.

## Liquidity and Capital Adequacy

### *Financial Models*

Ginnie Mae's Policy and Financial Analysis Model (PFAM) provides information regarding Ginnie Mae's

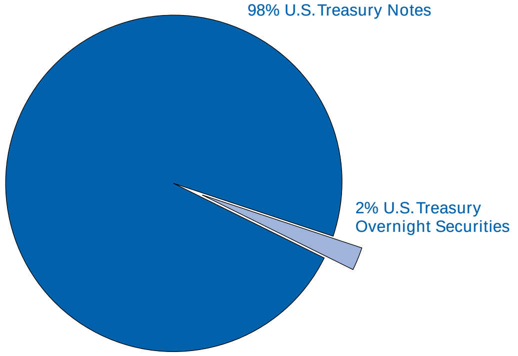
financial position by estimating current and future cash flows based on econometrically estimated claim and prepayment rates and a simulation of issuer default behavior. Using the PFAM, Ginnie Mae is able to evaluate the adequacy of its capital under a variety of economic conditions and to understand the financial implications of policy decisions.

In fiscal year 1998, Ginnie Mae made several enhancements to the PFAM. The multifamily portion of the model now includes information about the loans in Ginnie Mae's portfolio that carry Section 8 assistance. This information allows the model to address the discrepancy in the percentage of loans with Section 8 subsidies in Ginnie Mae's portfolio compared to the overall FHA-insured portfolio of loans, which has a much higher concentration of Section 8 loans. Additionally, the single family econometric model incorporated several changes. The primary modification was the introduction of a new demand module to improve the estimation of the loan to value and loan size distributions of FHA's future loan volume. Finally, recent pool and loan level data from the FHA and the VA were incorporated into the model, and the variables within the econometric and cash flow models were updated to reflect current market conditions.

Ginnie Mae has also modified the Scenario Manager of the PFAM to accommodate the Credit Subsidy Module. The modifications allow Ginnie Mae to calculate a credit subsidy rate for future books of business.

### *Liquidity*

Ginnie Mae's role in supporting expanded affordable housing in America through secondary market vehicles is ongoing through the use of the guaranty of full faith and credit of the U.S. Government. Thus, these program activities require a degree of liquid assets to further Ginnie Mae's initiatives. These needs are driven by the development of new secondary market vehicles, the timely payment of pass-throughs to security holders, and general operations. Due to successful cash management, program management and commitment to cost containment, Ginnie Mae has not been required to obtain appropriations or other debt financing sources.



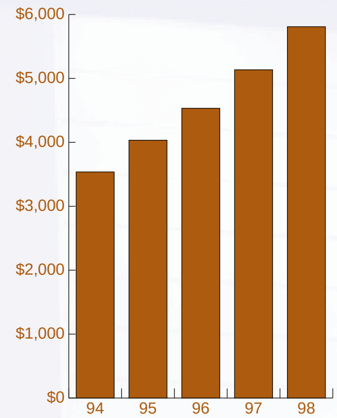

**Components of Investment 1998**

Ginnie Mae's primary sources of cash are MBS and Multiclass Guaranty Fee Income, Commitment Fee Income and Interest Income. As a result of these sources, at September 30, 1998, Ginnie Mae reported funds in the U.S. Treasury of $778.7 million compared with $155.8 million at September 30, 1997. The increase in the funds in the Treasury is influenced by the Credit Reform Act of 1990. This Act requires that Ginnie Mae segregate funds held with the U.S. Treasury between Liquidating and

Financing accounts. Funds received from activity originating prior to fiscal year 1991 are accounted for in the Liquidating accounts, while funds received from MBS fees for activity originating after fiscal year 1991 are maintained in the Financing accounts. For Credit Reform purposes, funds in the Financing account are deposited into an interest bearing account with the U.S. Treasury.

**Composition of Treasury Securities**
(percent of total)

| Maturity | 1998 | 1997 |
|---|---|---|
| Less than 1 Year | 11% | 9% |
| 1-5 Years | 51 | 47 |
| 5-10 Years | 38 | 44 |




**Capital Reserves**
**(Investments of U.S. Government)**
(dollars in millions)

In addition to the funds in the U.S. Treasury, Ginnie Mae's investments totaled $5.45 billion, compared with $5.38 billion in the prior year. Throughout 1998, Ginnie Mae continued its investment strategy of extending the maturity range of its securities portfolio, thereby increasing interest income while not increasing the risk of cash shortages leading to the premature redemption of securities. Of the $5.5 billion investment balance at September 30, 1998, $115.3 million was held in overnight certificates. The balance of the portfolio's maturities is spread over time to ensure that Ginnie Mae has a ready source of funds to meet emergency liquidity needs.

### *Capital Adequacy*

Ginnie Mae's activities involving the guaranty of MBSs have historically operated at a profit, and Ginnie Mae has incurred no borrowings to finance its operations. Ginnie Mae's net income builds and strengthens the corporation's capital base and programs. Ginnie Mae also maintains adequate capital to withstand downturns in the housing market which, in turn, may cause severe defaults. Backing Ginnie Mae's capital is the full faith and credit guaranty of the U.S. Government.

As of September 30, 1998, Ginnie Mae had an Investment of U.S. Government balance of $5.8 billion after establishing reserves for losses on its credit activities compared with $5.1 billion as of September 30, 1997. Ginnie Mae's net earnings are used to build sound reserves. Over the past three years, Ginnie Mae has increased its capital ratio (investment of government plus loan loss reserves as a percentage of total assets and RPB) from 1.00 percent to 1.15 percent. To access the strength of its capital position, Ginnie Mae uses a "stress test" methodology that measures Ginnie Mae's ability to withstand severe economic conditions.

## Risk Management

Ginnie Mae continues to enhance its automated systems and business processes to increase the efficiency of its operations and to reduce its business risk. During fiscal year 1998, Ginnie Mae continued periodic reviews of all master subservicers to assure compliance with the terms and conditions of their servicing contracts with Ginnie Mae.

As a direct result of these reviews, improvements in accounting and statistical reports prepared by the master subservicers have been achieved, aiding Ginnie Mae in the management and liquidation of defaulted portfolios. Additionally, in fiscal year 1998, major Ginnie Mae contractors were reviewed for contract compliance. The audits and reviews provided Ginnie Mae with a mechanism for continuing to strengthen its internal controls and minimize risks.

## Compliance with the CFO Act

Ginnie Mae has prepared a separate management report in compliance with the Chief Financial Officers Act of 1990 that contains detailed information. It is available upon request from the Ginnie Mae Office of Finance at (202) 401-2064.

2001 M Street, NW, Washington, DC 20036

## Independent Auditors' Report

To the Inspector General,
U.S. Department of Housing and Urban Development:

We have audited the 1998 and 1997 financial statements of the Government National Mortgage Association (Ginnie Mae). The objective of our audits was to express an opinion on the fair presentation of Ginnie Mae's financial statements based on our audits. In connection with our audits we also considered Ginnie Mae's internal control over financial reporting and tested Ginnie Mae's compliance with provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

In our opinion, Ginnie Mae's 1998 and 1997 financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles.

We noted no matters involving internal control over financial reporting and its operations that we consider to be material weaknesses.

The results of our tests of compliance disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as applicable to government corporations.

Our opinion on Ginnie Mae's financial statements, our consideration of internal control over financial reporting, our tests of Ginnie Mae's compliance with certain laws and regulations and our responsibilities are discussed in the remainder of our report.

The Office of Inspector General (OIG) is required to conduct an annual audit of Ginnie Mae under the provisions of the Chief Financial Officers (CFO) Act of 1990. To fulfill that responsibility, OIG contracted with the independent certified public accounting firm of KPMG LLP to conduct the audit for the year ended September 30, 1998. The complete OIG report (99-FO-171-0001) is included in the separate management report Ginnie Mae prepared pursuant to the CFO Act which is available upon request from Ginnie Mae.

## Opinion On Financial Statements

We have audited the accompanying balance sheets of Ginnie Mae, as of September 30, 1998 and 1997, and the related statements of revenues and expenses and changes in investment of U.S. government and cash flows for the years then ended. These financial statements are the responsibility of Ginnie Mae's management. Our responsibility is to express an opinion on these financial statements based on our audits.

In our opinion, the accompanying 1998 and 1997 financial statements present fairly, in all material respects, the financial position of Ginnie Mae as of September 30, 1998 and 1997, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

## Internal Controls Over Financial Reporting

We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses under standards established by the American Institute of Certified Public Accountants (AICPA) and OMB Bulletin No. 98-08, as applicable to government corporations.

Material weaknesses are conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under standards issued by the AICPA and OMB Bulletin 98-08, as applicable to government corporations.

Although not considered material weaknesses, we noted other matters involving internal controls and their operation during our audit which have been reported to Ginnie Mae's management in a separate letter.

## Compliance with Laws And Regulations

The results of our tests, performed as part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 98-08, as applicable to government corporations.

## Responsibilities

*Management's Responsibility.* The Chief Financial Officers (CFO) Act of 1990 requires federal agencies to report annually to Congress on their financial status and any other information needed to fairly present the agencies' financial position and results of operations. To meet the CFO Act reporting requirements, Ginnie Mae prepares annual financial statements. Ginnie Mae is an agency operated by the U.S. Department of Housing and Urban Development (HUD).

Management has the responsibility for:

- preparing the financial statements in conformity with generally accepted accounting principles;

- establishing and maintaining internal controls over financial reporting; and
- complying with applicable laws and regulations.

In fulfilling these responsibilities, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control over financial reporting are to provide management with reasonable, but not absolute, assurance that:

- transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with generally accepted accounting principles;
- assets are safeguarded against loss from unauthorized acquisition, use or disposition; and
- transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

*Auditors' Responsibility.* Our responsibility is to express an opinion on the 1998 and 1997 financial statements of Ginnie Mae based on our audits. We conducted our audits in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 98-08, as applicable to government corporations. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement and presented fairly in accordance with generally accepted accounting principles. We believe that our audits provide a reasonable basis for our opinion. Our audits were not designed to test the requirements of OMB Bulletin No. 98-08 relating to the *Federal Financial Management Improvement Act* (FFMIA), which is not considered applicable at the Ginnie Mae level. FFMIA requirements will be reviewed and reported on at the HUD consolidated level. Our audits were also not designed to test the requirements of OMB Bulletin No. 98-08 relating to the Credit Reform Act of 1990, because Ginnie Mae's financial statements were prepared in conformity with generally accepted accounting principles.

In planning and performing our audit of the financial statements of Ginnie Mae, we considered internal control over financial re-porting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion on internal controls.

As part of obtaining reasonable assurance about whether Ginnie Mae's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

In order to fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall financial statement presentation; and

- tested compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts.

With respect to internal control, we obtained an understanding of Ginnie Mae's significant internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls.

Because of inherent limitations in internal control, fraud may nevertheless occur and not be detected. Also, projection of an evaluation of internal controls over financial reporting to future periods is subject to the risk that internal control procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

This report is intended solely for the information and use of the HUD Office of the Inspector General, the management of HUD and Ginnie Mae, OMB, and Congress and is not intended to be and should not be used by anyone other than those specified parties.

KPMG LLP

February 12, 1999
Washington, D.C.

# Balance Sheets

| September 30, | 1998 | 1997 |
|---|---|---|
| (In thousands) | | |
| **Assets:** | | |
| Funds in U.S. Treasury | $ 778,700 | $ 155,800 |
| U.S. Government securities - Note B | 5,448,300 | 5,382,000 |
| Mortgages held for sale, net - Note C | 4,900 | 3,800 |
| Properties held for sale, net - Note D | 1,500 | 3,000 |
| Accrued interest and other receivables | 103,600 | 101,700 |
| Advances against defaulted Mortgage-Backed Security pools, net - Note E | 29,400 | 29,100 |
| Claims against HUD/FHA and VA | – | 7,500 |
| **Total Assets** | $ 6,366,400 | $ 5,682,900 |
| **Liabilities and Investment of U.S. Government** | | |
| **Liabilities:** | | |
| Reserve for loss on Mortgage-Backed Securities Program - Note F | $ 511,200 | $ 507,700 |
| Deferred revenue | 24,000 | 19,200 |
| Deferred liabilities and deposits | 1,100 | 1,700 |
| Accounts payable and accrued liabilities | 20,800 | 19,700 |
| **Total Liabilities** | 557,100 | 548,300 |
| **Commitments and Contingencies - Note I** | | |
| Investment of U.S. Government | 5,809,300 | 5,134,600 |
| **Total Liabilities and Investment of U.S. Government** | $ 6,366,400 | $ 5,682,900 |

See accompanying notes to financial statements.

# Statements of Revenues and Expenses and Changes in Investment of U.S. Government

| For the year ended September 30, | 1998 | 1997 |
|---|---|---|
| (In thousands) | | |
| **Revenues:** | | |
| Mortgage-Backed Securities Program income | $ 392,300 | $ 353,800 |
| Interest income | 362,700 | 318,200 |
| Other income, net | 12,400 | 14,700 |
| **Total Revenues** | 767,400 | 686,700 |
| **Expenses:** | | |
| Mortgage-Backed Securities Program expenses | 36,300 | 29,400 |
| Administrative and other expenses | 9,300 | 9,300 |
| **Total Expenses** | 45,600 | 38,700 |
| Provision for loss on Mortgage-Backed Securities Program–Note F | 47,100 | 46,800 |
| **Excess of Revenues Over Expenses** | 674,700 | 601,200 |
| **Investment of U.S. Government at Beginning of Year:** | 5,134,600 | 4,533,400 |
| Excess of revenues over expenses | 674,700 | 601,200 |
| **Investment of U.S. Government at End of Year** | $ 5,809,300 | $ 5,134,600 |

See accompanying notes to financial statements.

# Statements of Cash Flows

| For the year ended September 30, | 1998 | 1997 |
|---|---|---|
| (In thousands) | | |
| **Cash flows from operating activities:** | | |
| Interest received | $362,200 | $301,800 |
| Mortgage-Backed Securities Program fees | 390,900 | 352,400 |
| Advances against defaulted Mortgage-Backed Security pools | (25,800) | (5,100) |
| Mortgage-Backed Securities Program losses and expenses | (41,600) | (36,300) |
| Other income received | 17,200 | 23,300 |
| Administrative expenses | (9,300) | (9,300) |
| Purchases of mortgages/properties, net of disposal | (8,400) | (15,900) |
| Recoveries from FHA and VA | 4,000 | 10,600 |
| **Net cash provided by operating activities** | 689,200 | 621,500 |
| **Cash flows from investing activities:** | | |
| Purchase of U.S. Treasury Securities, net | (66,300) | (596,900) |
| **Net cash used by investing activities** | (66,300) | (596,900) |
| **Net increase in cash** | 622,900 | 24,600 |
| **Funds in US Treasury at beginning of year** | 155,800 | 131,200 |
| **Funds in US Treasury at end of year** | $778,700 | $155,800 |

See accompanying notes to financial statements.

## Statements of Cash Flows

| September 30, | 1998 | 1997 |
|---|---|---|
| (In thousands) | | |
| **Net excess of revenue over expenses** | $674,700 | $601,200 |
| **Adjustments to reconcile net excess of revenue over expenses to net cash provided by operating activities:** | | |
| Provision for loss on Mortgage-Backed Securities Program | 47,100 | 46,800 |
| Increase in accrued interest and other receivables | (400) | (16,400) |
| (Increase) decrease in advances against defaulted Mortgage-Backed Security pools | (300) | 400 |
| Decrease in deposit liabilities | (600) | (100) |
| Increase (decrease) in accounts payable and accrued liabilities | 1,100 | (1,000) |
| Increase in deferred revenue | 4,800 | 4,400 |
| Decrease in Mortgage-Backed Securities reserve relating to operating activities | (37,200) | (13,800) |
| **Total adjustments** | 14,500 | 20,300 |
| **Net cash provided by operating activities** | $689,200 | $621,500 |

See accompanying notes to financial statements.

## Notes to the Financial Statements

### Note A—Organization and Summary of Significant Accounting Policies

The Government National Mortgage Association (Ginnie Mae) was created in 1968 through amendment of Title III of the National Housing Act as a Government corporation within the Department of Housing and Urban Development (HUD).

The mortgage-backed securities (MBS) program is Ginnie Mae's primary ongoing activity. The purpose of the program is to increase liquidity in the secondary mortgage market and attract new sources of capital for residential mortgage loans. Through the program, Ginnie Mae guarantees the timely payment of principal and interest on securities backed by pools of mortgages issued by private mortgage institutions. The guaranty is backed by the full faith and credit of the United States Government. Ginnie Mae requires that the mortgages be insured or guaranteed by the Federal Housing Administration (FHA), the Rural Housing Service (RHS), (formerly Farmer's Home Administration), or the Department of Veterans Affairs (VA).

These MBS securities are not assets of Ginnie Mae, nor are the related outstanding securities liabilities; accordingly, neither is reflected on the accompanying balance sheets.

*Funds in U.S. Treasury:* All of Ginnie Mae's receipts and disbursements are processed by the U.S. Treasury which, in effect, maintains Ginnie Mae's bank accounts. For purposes of the Statement of Cash Flows, Funds in U.S. Treasury are considered cash.

*U.S. Government Securities:* Ginnie Mae classifies its investments in U.S. Government Securities based on its ability and positive intent to hold them to maturity. Therefore, Ginnie Mae's investment in U.S. Government securities is recorded at amortized cost. Discounts and premiums are amortized on a level yield basis, over the life of the related security.

*Mortgage Loans Held for Sale:* Mortgage loans held for sale are carried at the lower of cost or fair value, with any unrealized losses included in current period earnings. The related allowance for loss is established to reduce the carrying value of mortgages held for sale to their estimated fair value which is based on the amount Ginnie Mae expects to realize in cash upon sale of the mortgages.

*Properties Held for Sale:* Foreclosed assets are recorded at the lower of cost or fair value less estimated costs to sell. The related allowance for loss is established to reduce the property carrying value to fair value less costs to sell. Property related expenses incurred during the holding period are included in Mortgage-Backed Securities program expenses.

*Advances Against Defaulted Mortgage-Backed Security Pools:* Advances against defaulted mortgage-backed security pools represent payments made to fulfill Ginnie Mae's guaranty of timely principal and interest payment to the MBS security holders. Such advances are reported net of an allowance for doubtful recoveries to the extent management believes they will not be recovered. The allowance for doubtful recoveries is estimated based on actual and expected recovery experience and is adjusted for FHA, VA and RHS claims that have been filed.

*Reserve for Loss on MBS Program:* In the operation of its MBS programs, Ginnie Mae estimates the cost of liquidating its existing portfolio of mortgage servicing rights acquired from defaulted issuers and expected future issuer defaults. Reserves are established to the extent management believes issuer defaults are probable and FHA, VA and RHS insurance or guaranty are insufficient to recoup Ginnie Mae expenditures. The reserves are increased by provisions charged as an expense in the Statements of Revenues and Expenses and reduced by charge-offs, net of recoveries.

*Recognition of Revenues and Expenses:* Ginnie Mae receives monthly guarantee fees for each MBS mortgage pool based on a percentage of the pool's outstanding balance. Fees received for Ginnie Mae's guaranty of mortgage-backed securities are recognized as earned. Fees received for commitments to guaranty mortgage-backed securities are recognized when the commitments are granted. Ginnie Mae recognizes as income the major portion of fees related to the issuance of multiclass securities in the period the fees are received, with the balance deferred and amortized over the weighted averaged life of the underlying mortgages to match the recognition of related administrative expenses. Losses on assets acquired through liquidation and claims against HUD/FHA and VA are recognized when they occur.

*Use of Estimates:* The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## Note B—U.S. Government Securities

The U.S. Government Securities portfolio is held in special market based U.S. Treasury securities that are bought and sold at composite prices received from the Federal Reserve Bank of New York. These securities are maintained in book entry form at the Bureau of Public Debt. The coupon rates of Ginnie Mae's current holdings range from 5.0 percent to 8.0 percent. The amortized cost and fair values as of September 30, 1998 were as follows:

| Dollars in thousands | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Treasury Overnight Certificates | $ 115,300 | $ – | $ – | $ 115,300 |
| U.S. Treasury Notes | 5,333,000 | 384,600 | – | 5,717,600 |
| | $ 5,448,300 | $ 384,600 | $ – | $ 5,832,900 |

The amortized cost and fair values as of September 30, 1997 were as follows:

| Dollars in thousands | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Treasury Overnight Certificates | $ 217,800 | $ – | $ – | $ 217,800 |
| U.S. Treasury Notes | 5,164,200 | 87,600 | 24,100 | 5,227,700 |
| | $ 5,382,000 | $ 87,600 | $ 24,100 | $ 5,445,500 |

The amortized cost, fair value and annual weighted average interest rates of debt securities at September 30, 1998, by contractual maturity date, are as follows:

| Dollars in thousands | Amortized Cost | Fair Value | Weighted Average Interest Rate |
|---|---|---|---|
| Due within one year | $ 628,500 | $ 633,400 | 4.62% |
| Due after one year through five years | 2,754,800 | 2,864,000 | 4.37% |
| Due after five years through ten years | 2,065,000 | 2,335,500 | 4.40% |
| | $ 5,448,300 | $ 5,832,900 | 4.41% |

The amortized cost, fair value and annual weighted average interest rates of debt securities at September 30, 1997, by contractual maturity date, were as follows:

| Dollars in thousands | Amortized Cost | Fair Value | Weighted Average Interest Rate |
|---|---|---|---|
| Due within one year | $ 498,000 | $ 497,300 | 5.72% |
| Due after one year through five years | 2,536,900 | 2,549,700 | 5.88% |
| Due after five years through ten years | 2,347,100 | 2,398,500 | 6.13% |
| | $5,382,000 | $ 5,445,500 | 5.98% |

## Note C—Mortgages Held For Sale, Net

Ginnie Mae acquires certain mortgages from defaulted issuers' portfolios to bring the pools into conformity with MBS program requirements. Mortgages ineligible to remain in pools when servicing-rights are sold are acquired by Ginnie Mae. Mortgages held for sale were as follows:

| September 30,<br>Dollars in thousands | 1998 | 1997 |
|---|---|---|
| Unpaid principal balance | $ 7,100 | $ 7,000 |
| Allowance for losses | (2,200) | (3,200) |
| Mortgages held for sale, net | $ 4,900 | $ 3,800 |

## Note D—Properties Held For Sale, Net

Ginnie Mae acquires residential properties by foreclosure out of the defaulted issuer portfolios in order to comply with MBS program requirements. Balances and activity in the properties held for sale were as follows:

| September 30,<br>Dollars in thousands | 1998 | 1997 |
|---|---|---|
| Cost of properties, beginning of year | $ 4,700 | $ 8,100 |
| Additions | 16,000 | 23,000 |
| Dispositions and losses | (17,400) | (26,400) |
| Cost of properties, end of year | 3,300 | 4,700 |
| Allowance for losses and costs to sell | (1,800) | (1,700) |
| Properties held for sale, net | $ 1,500 | $ 3,000 |

## Note E—Advances against Defaulted Mortgage-Backed Security Pools

Under its MBS guaranty, Ginnie Mae advanced $127.6 million in 1998 and $93.0 million in 1997 against defaulted mortgage-backed security pools to ensure timely pass-through payments. Recoveries of advances, either from late payment remittances or through FHA insurance or VA guaranty proceeds, were $97.8 million in 1998 and $84.4 million in 1997. Advances of $3.8 million were written off in 1998; there were $2.9 million of write-offs in 1997.

Unrecovered advances outstanding against defaulted mortgage-backed security pools, net of allowance for doubtful recoveries, were as follows:

| September 30,<br>Dollars in thousands | 1998 | 1997 |
|---|---|---|
| Advances against defaulted pools | $ 350,500 | $ 324,500 |
| Allowance for losses | (321,100) | (295,400) |
| Advances against defaulted pools, net | $ 29,400 | $ 29,100 |

## Note F—Reserve for Loss on MBS Program

Ginnie Mae establishes a reserve for losses through a provision charged to operations when, in management's judgment, defaults of issuers of mortgage-backed securities become probable. The reserve for losses is based on an analysis of the MBS portfolio outstanding. In estimating losses, management utilizes a statistically based model that evaluates numerous factors, including, but not limited to, general and regional economic conditions, mortgage characteristics, and actual and expected future default and loan loss experience. Management also considers uncertainties related to estimations in the reserve setting process. The reserve is relieved as losses are realized from the disposal of the defaulted issuers' portfolios. Ginnie Mae recovers part of its losses through servicing fees on the performing portion of the portfolios and the sale of servicing rights which inure to Ginnie Mae upon the default of the issuer. Ginnie Mae management believes that its reserve is adequate to cover probable losses from defaults by issuers of Ginnie Mae guaranteed mortgage-backed securities. Changes in the reserve were as follows:

| Dollars in thousands | Single Family | Multifamily | Manufactured Housing | Total |
|---|---|---|---|---|
| September 30, 1996 | $150,000 | $ 56,700 | $ 265,000 | $ 471,700 |
| Recoveries | 13,100 | 11,100 | 18,500 | 42,700 |
| Realized losses | (23,900) | (900) | (28,700) | (53,500) |
| Provision | 57,000 | (10,200) | – | 46,800 |
| September 30, 1997 | $ 196,200 | $ 56,700 | $ 254,800 | $ 507,700 |
| September 30, 1997 | $ 196,200 | $ 56,700 | $ 254,800 | $ 507,700 |
| Recoveries | 6,000 | 700 | 10,200 | 16,900 |
| Realized Losses | (35,100) | (600) | (24,800) | (60,500) |
| Provision | 32,500 | – | 14,600 | 47,100 |
| September 30, 1998 | $ 199,600 | $ 56,800 | $ 254,800 | $ 511,200 |

Ginnie Mae incurs loss when insurance and guarantees do not cover expenses that result from issuer defaults. Such expenses include (1) unrecoverable losses on individual mortgage defaults because of coverage limitations on mortgage insurance or guarantees, (2) ineligible mortgages included in defaulted Ginnie Mae pools, (3) improper use of proceeds by an issuer, and (4) non-reimbursable administrative expenses and costs incurred to service and liquidate portfolios of defaulted issuers.

The reserve for losses is relieved as estimated losses are realized. To the extent realized losses differ from those previously estimated, Ginnie Mae may elect to increase or decrease its reserve depending on its assessment of risks and losses associated with probable issuer defaults. For fiscal year 1998 Ginnie Mae increased its provision for losses for its single family portfolio to reflect increased risk with respect to recovery of certain losses and expenses associated with issuer defaults.

At September 30, 1998, the balances of Ginnie Mae managed portfolios were $478.1 million in single family, $0 in multifamily, and $149 million in manufactured housing, and in fiscal year 1997, $606.7 million in single family, $0 in multifamily and $220.3 million in manufactured housing. As Ginnie Mae's defaulted issuer portfolio decreases, original estimates are compared with actual results over time and the adequacy of the reserve is assessed and if necessary, the reserve is adjusted.

## Note G—Financial Instruments With Off-Balance Sheet Risk

Ginnie Mae is subject to credit risk for financial instruments not reflected in its balance sheet in the normal course of operations. These financial instruments include guarantees of mortgage-backed securities and commitments to guaranty mortgage-backed securities. The Ginnie Mae guaranteed security is a pass through security whereby mortgage principal and interest payments, except for servicing and guaranty fees, are passed through to the security holders monthly. Mortgage prepayments are also passed through to security holders. As a result of the structure of the security, Ginnie Mae bears no interest rate or liquidity risk. Ginnie Mae's exposure to credit loss is contingent on the event of non-performance by other parties to the financial instruments. Other than those issuers considered in the reserve for loss on the MBS program (see Note F), Ginnie Mae does not anticipate non-performance by the counterparties.

Ginnie Mae guarantees the timely payment of principal and interest to mortgage-backed security holders should the issuers fail to do so. The securities are backed by pools of insured or guaranteed FHA, RHS, or VA mortgage loans. On September 30, 1998 the amount of securities outstanding which are guaranteed by Ginnie Mae was $542.2 billion; however, Ginnie Mae's potential loss is considerably less because the underlying mortgages serve as primary collateral and the FHA, RHS, and VA insurance or guaranty to indemnify Ginnie Mae for most losses.

During the mortgage closing period and prior to granting its guaranty, Ginnie Mae enters into commitments to guaranty mortgage-backed securities. The commitment ends when the securities are issued or the commitment period expires. Ginnie Mae's risk related to outstanding commitments is much less than for outstanding securities due, in part, to Ginnie Mae's ability to limit commitment authority granted to individual issuers of mortgage-backed securities.

Outstanding MBS securities and commitments were as follows:

| September 30,<br>Dollars in billions | 1998 | 1997 |
|---|---|---|
| Outstanding MBS securities | $ 542.2 | $530.6 |
| Outstanding MBS commitments | $ 22.2 | $ 31.0 |

## Note H—Concentrations of Credit Risk

Concentrations of credit risk exist when a significant number of counterparties (e.g., issuers and borrowers) engage in similar activities or are susceptible to similar changes in economic conditions that could affect their ability to meet contractual obligations. Generally, Ginnie Mae's MBS pools are diversified among issuers and geographic areas. No significant geographic concentrations of credit risk exist; however, to a limited extent, securities are concentrated among issuers as noted below as of September 30, 1998 (dollars in billions):

| | Single Family | | Multifamily | | Manufactured | |
|---|---|---|---|---|---|---|
| Dollars in billions | Number of Issuers | Remaining Principal Balance | Number of Issuers | Remaining Principal Balance | Number of Issuers | Remaining Principal Balance |
| Largest performing issuers | 15 | $344.3 | 10 | $10.2 | 1 | $0.7 |
| Other performing issuers | 287 | 181.7 | 116 | 4.4 | 5 | 0.2 |
| Defaulted issuers | 11 | 0.5 | – | – | 23 | 0.1 |

During fiscal year 1998, Ginnie Mae acquired one single family issuer portfolio with a remaining principal balance of $8.3 million and one manufactured housing issuer portfolio with a remaining principal balance $328 thousand.

In fiscal year 1998, Ginnie Mae issued a total of $36.9 billion in its multiclass securities program. The estimated outstanding balance at September 30, 1998 was $83.4 billion. These guaranteed securities do not subject Ginnie Mae to additional credit risk beyond that assumed under the MBS program.

## Note I—Commitments and Contingencies

As of September 30, 1998, Ginnie Mae was named in several legal actions, virtually all of which involved claims under the guaranty program. It is not possible to predict the eventual outcome of the various actions; however, in the opinion of management and counsel the resolution of these claims will not result in adverse judgments to such an extent they would materially affect the financial position or results of operations of Ginnie Mae.

## Note J—Related Parties

Ginnie Mae is subject to controls established by government corporation control laws (32 U.S.C. 9101 through 9109) and management controls by the Secretary of HUD and the Director of the Office of Management and Budget (OMB). Such controls could affect Ginnie Mae's financial position or operating results in a manner that differs from those that might have been obtained if Ginnie Mae were autonomous.

HUD provides Ginnie Mae, without charge, use of office space and equipment. Ginnie Mae reimbursed HUD $9.3 million in 1998 and $9.3 million in 1997 for administrative expenses allocated to Ginnie Mae including payroll and payroll related costs.

Payroll related costs for which Ginnie Mae reimbursed HUD included matching contributions to the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). Although Ginnie Mae funds a portion of pension benefits under these programs, it has no liability for future payments to employees under these programs and does not account for the assets of CSRS or FERS nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management (OPM) and are allocated to HUD. OPM also accounts for the health and life insurance programs for Federal employees and retirees and funds the non-employee portion of the costs of such program.

Cash receipts, disbursements and investment activities are processed by the U.S. Treasury. Funds in the U.S. Treasury represent cash currently available to finance purchase commitments and pay current liabilities. Ginnie Mae has authority to borrow from the U.S. Treasury to finance its operations in lieu of appropriations if necessary.

## Note K—Fair Value of Financial Instruments

The following table shows the fair value of financial instruments to which Ginnie Mae has a contractual obligation to deliver or a contractual right to receive cash from another entity as of September 30, 1998 and 1997:

| | Fair Value | |
|---|---|---|
| Dollars in thousands | 1998 | 1997 |
| U.S. Government Securities | $5,832,900 | $5,445,500 |
| Funds in U.S. Treasury | 778,700 | 155,800 |
| Advances against MBS Pools | 29,400 | 29,100 |
| Other Assets | 108,500 | 113,000 |
| Unrecognized Financial Instruments | 1,007,481 | 1,132,300 |
| Other Liabilities | 45,900 | 40,600 |

The fair value of Ginnie Mae's largest asset, U.S. Government Securities, is estimated based on quoted market prices for securities of similar maturity. The fair values of Funds in U.S. Treasury, Advances against MBS Pools, Other Assets and Other Liabilities are not materially different from their carrying values.

Unrecognized financial instruments comprise the net fair value of the fee Ginnie Mae receives for the guaranty of timely payment of principal and interest. The value was derived by discounting the estimated future net cash flows relating to Ginnie Mae guaranteed mortgage-backed securities outstanding. The assumptions and estimates used in calculating the fair value of unrecognized financial instruments are based on management's evaluation of economic conditions and, therefore, are not subject to precise quantification. These discounted cash flows consist of estimated future guaranty fees, taking into account estimated prepayments, in excess of
1) projected losses relating to the MBS program, including projected losses on defaulted pools of mortgage-backed securities, and 2) projected administrative expenses. The discount rate approximates an interest rate for risk-free instruments of a tenor and duration similar to the Ginnie Mae guaranty. The fair value of Ginnie Mae's guaranty recognizes the present value of future fees which are not recognized under generally accepted accounting principles since to do so would record revenue prior to realization. The decrease in the fair value of unrecognized financial instruments from 1997 to 1998 is primarily attributable to the impact of interest rate volatility.

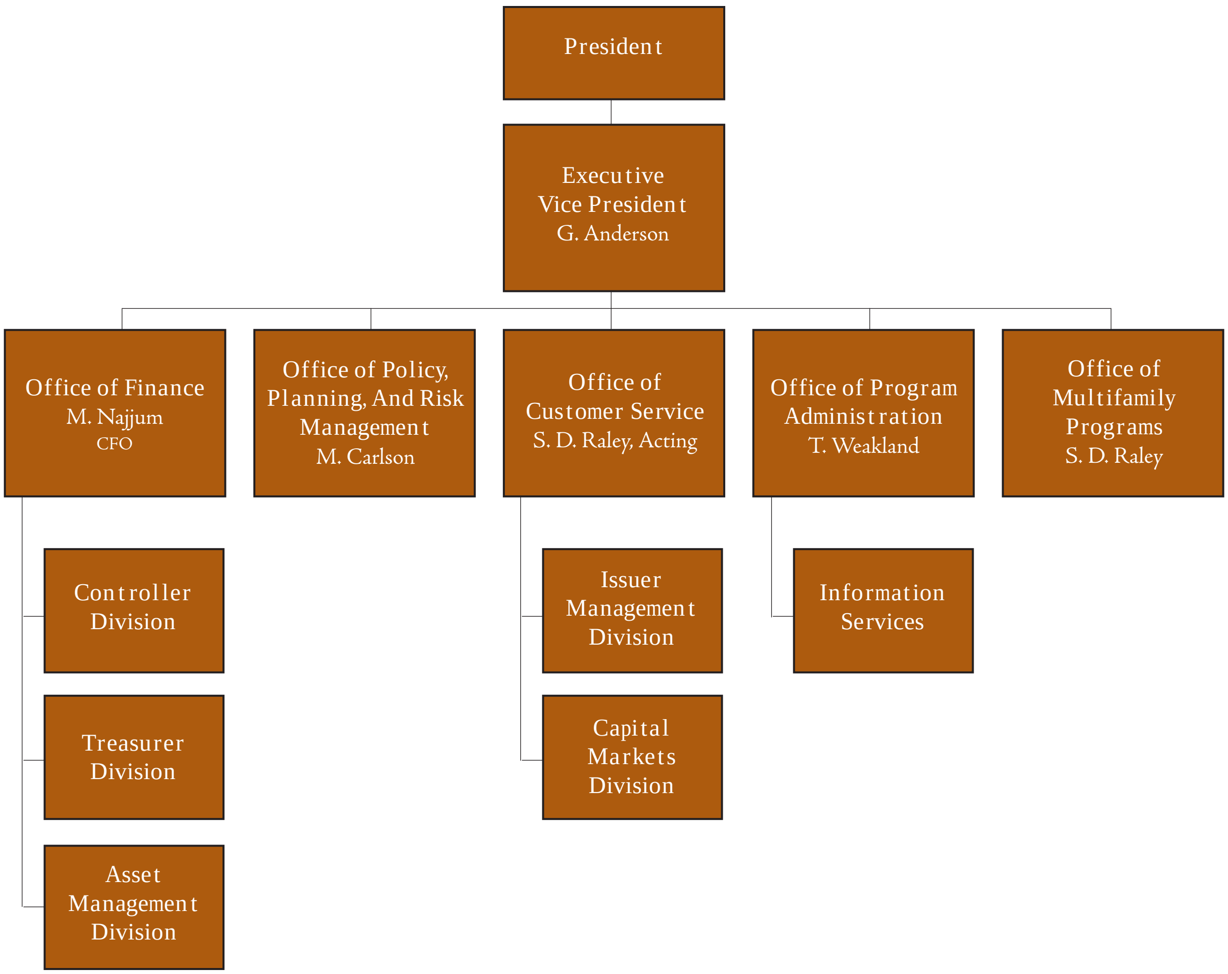
Ginnie Mae's standing as a Federal government corporation whose guaranty carries the full faith and credit of the U.S. Government makes it difficult to determine what the fair value of its financial instruments would be in the private market. Accordingly, the amount Ginnie Mae would realize upon sale of its financial instruments could differ, perhaps materially, from the amounts shown above.

## Note L—Credit Reform

The primary purpose of the Federal Credit Reform Act of 1990, which became effective on October 1, 1991, is to more accurately measure the cost of Federal credit programs and to place the cost of such credit programs on a basis equivalent with other Federal spending. Credit Reform focuses on those credit programs that operate at a loss by providing for appropriated funding, within budgetary limitations, to subsidize the loss element of the credit program. Negative subsidies, calculated for credit programs operating at a profit, normally result in the return of funds to Treasury. OMB specifies the methodology an agency is to follow in accounting for the cash flows of its credit programs.

Ginnie Mae's credit activities have historically operated at a profit. Ginnie Mae has not incurred borrowings or received appropriations to finance its credit operations, nor does it anticipate the need to receive such funding.
As of September 30, 1998, Ginnie Mae had an investment in U.S. Government of $5.8 billion after establishing reserves for potential losses on its credit activities. Pursuant to the statutory provisions under which Ginnie Mae operates, its net earnings are used to build sound reserves. In the opinion of management, Ginnie Mae is in compliance with OMB implementation requirements for the Federal Credit Reform Act, as applicable to government corporations.

# The Ginnie Mae Organization



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Andrew Cuomo, Secretary

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U.S. Department of Housing and Urban Development
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